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STATE PLEASE PASS TO USTR MCHALE

E.O. 12958: N/A

TAGS: ECON EFIN ECPS PGOV PREL CH HK  
SUBJECT: PCCW SALE: LI FAMILY TIES REVEALED

REF: A. A) HONG KONG 2607

¶B. B) HONG KONG 2851

¶C. C) HONG KONG 3987

¶11. (U) SUMMARY. In early November, the Singapore Exchange announced that Richard Li would not be permitted to vote on the sale of Singapore-listed Pacific Century Regional Development's (PCRD) 23% share of PCCW to Francis Leung. Richard Li is the Chairman and 75% stakeholder of PCRD, Li is also the son of Hong Kong's richest businessman, Li Ka-shing.

In announcing that Li would not be permitted to vote at the late November special meeting of PCRD shareholders, the Singapore Exchange stated that "PCRD was unable to assure the exchange on whether Mr. Li or related parties, including his father, Li Ka-shing, were involved in the sale." Since the Singapore Exchange's announcement it has emerged that Leung's backers in the purchase of PCRD's PCCW shares are Li Ka-shing and Telefonica, the Spanish telecom giant. With Li barred from voting it is possible that minority investors in PCRD could vote to block the sale.

¶12. (SBU) Another aspect that clouds this deal is the influence mainland China exerted. If the deal goes through, China Netcom, the mainland telecom giant, will end up as the largest single shareholder with 20% of the company. Analysts speculate that Telefonica, which has a joint-venture with China Netcom in the Mainland, might swap PCCW shares for a stake in China Netcom. This scenario would result in the Chinese telecom giant gaining even more leverage over PCCW. Analysts speculate the PCCW-China Netcom-Telefonica deal could lead to a consolidation of the mainland and Hong Kong telecom markets. In Hong Kong, legislators, the Broadcasting Authority (BA), and the Office of the Telecommunications Authority (OFTA) are examining the deal's impact on telecommunications competitiveness. The Hong Kong Broadcasting Authority is also looking at whether the deal could create a media monopoly as PCCW owns NOW Broadband, Hong Kong's major cable television provider, and Li Ka-shing's Hutchinson Whampoa is the sole owner of the territory's Metro Radio. END SUMMARY.

¶13. (U) In July 2006, Singapore-listed Pacific Century Regional Developments (PCRD) - 75% of which is owned by Richard Li ) announced that it would sell its 23% stake in PCCW, the Hong Kong telecom and media giant, to Francis Leung, an associate of Richard Li's father, Li Ka-shing. This announcement put an end to two earlier bids by foreign firms for PCCW's telecom assets. China Netcom, the PRC telecom giant and a major stakeholder in PCCW, opposed the sale to foreign bidders. After the Leung deal was announced,

the Singapore Exchange (SGX) questioned Li and Leung over the sale because SGX regulations stipulate that if the money came from any direct member of Richard Li's family, Richard Li would lose his rights to vote on the deal. After weeks of denying any Li family involvement, Li Ka-shing, s spokesman acknowledged that Leung received a bridge loan from Li Ka-shing to help with the initial purchase offer. As a result, SGX barred Richard Li from voting on the deal, leaving the sale,s fate in the hands of minority shareholders of PCRD, many of whom reportedly preferred the two foreign bids for PCCW, s assets. On November 11, independent investors in PCRD recommended that PCRD, s shareholders reject the proposed sale because the price offered by Leung did not reflect the growth prospects of PCCW. PCRD shareholders will vote on the sale on November 30.

¶4. (U) If it goes through, the proposed deal will change the ownership structure of PCCW. China Netcom, currently the second largest shareholder, will become the majority holder with a 20% stake. Li Ka-shing, s Hong Kong and Canadian charities will gain a combined 12% stake of the company; Telefonica will have 8%. 2.65% will go to Leung, while Richard Li will retain 3.8%. The remaining shares will continue to be traded publicly. The new shareholding structure must be approved by December 20.

¶5. (SBU) China Netcom denied speculation that it would try to change the structure of PCCW, s Board of Directors. However, close ties between Telefonica and China Netcom cause analysts to doubt the Chinese company, s statements and to anticipate that it will attempt to gain control of the board. Telfonica acquired 5% of China Netcom last year. Together, the two companies will own 28% of PCCW. A Telefonica spokesman said that it plans to swap its PCCW shares for shares in China

HONG KONG 00004495 002 OF 002

Netcom, which would dramatically increase China Netcom, s stake in the Hong Kong company. A telecom analyst said that this arrangement between Telefonica and China Netcom could facilitate an eventual consolidation of PCCW and China Netcom. He noted that a full merger of the two companies would enable PCCW to grow in the Mainland telecom, internet and media markets. It also would be a symbolic step in the continued integration of Hong Kong into the mainland economy.

¶6. (U) Hong Kong regulators have expressed concern over the deal, s impact on competitiveness in the broadcasting and telecommunications sectors. Through Hutchinson Whampoa, Li Ka-shing owns, Metro Radio and Hutchinson Telecommunications. Since PCCW is the main provider of broadband television services in Hong Kong, the deal could violate the broadcasting, s ordinance, s cross-media restrictions that forbid one person from owning competing media outlets. These restrictions are geared to safeguard press freedoms in Hong Kong by guaranteeing a diversity of editorial content in the media. The Hong Kong Broadcasting Authority will examine whether the involvement of Li Ka-shing or any of the entities that he controls violates these cross-media restrictions.

¶7. (U) Albert Cheng, Chair of Legco Information Technology and Broadcasting (ITB) panel, also expressed concern over market domination in the telecom sector by Li Ka-shing, noting that Hutchinson Telecom already enjoys a large market share and that the potential purchase of PCCW stock will turn him into the dominant telecom figure in Hong Kong with a potential negative impact on the public. The ITB panel will hold hearings the week of November 20 on the sale, s impact on telecom market domination, potential monopolies, and cross-media ownership.

¶8. (SBU) Regulators and legislators have expressed concern over the way in which Li Ka-shing is trying to get around competition laws by having his charitable foundations, not his companies, make the purchase. Hong Kong regulators have stated they will investigate the funding sources, but to

block the sale, they must prove that Li Ka-shing is the ultimate beneficiary of his foundations. Analysts predict that this will be a difficult task even though Li recently donated HK\$4.04 billion dollars (US\$ 518 million) donation to his foundations for the purchase of PCCW. Legislator Emily Lau opined that such business tactics and closed door deals hurt small and independent Hong Kong investors, who have difficulty safeguarding their investments against large shareholders like Li, Leung and China Netcom. She believes that the deal tarnishes Hong Kong's international reputation as a transparent financial center and a rule of law society. She and others urge the government to examine the case closely.

Cunningham